

D.T.E. 04-9

Petition of Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each d/b/a KeySpan Energy Delivery New England, for approval of a gas resource portfolio management and gas sales agreement.

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FOR: KEYSPAN ENERGY DELIVERY NEW ENGLAND
Petitioner

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I. INTRODUCTION

On February 3, 2004, Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each d/b/a/ KeySpan Energy Delivery New England (collectively, “KeySpan” or “Company”), pursuant to Boston Gas Company, D.T.E. 03-40, at 227 (2003), submitted for approval by the Department of Telecommunications and Energy (“Department”) a gas resource portfolio management plan (“EKT Agreement” or “Agreement”) between KeySpan and Entergy-Koch Trading, LP. The Department has approved a similar asset management agreement in Boston Gas Company, Colonial Gas Company and Essex Gas Company, D.T.E. 99-76 (1999). The Company’s proposal was docketed as D.T.E. 04-9.

On March 24, 2004, pursuant to notice duly issued, the Department conducted a public hearing to afford interested persons the opportunity to comment on KeySpan’s proposal. The Attorney General of the Commonwealth (“Attorney General”) intervened as of right pursuant to G.L. c. 12, § 11E.

On September 2, 2004, the Department conducted an evidentiary hearing. The Company presented the testimony of Elizabeth D. Arangio, director of gas supply planning. The Company and the Attorney General filed initial briefs on September 30, 2004. KeySpan filed a reply brief on October 8, 2004. The evidentiary record consists of 46 exhibits and eight responses to record requests.

II. DESCRIPTION OF THE FILING

A. Request for Proposals Process

On January 22, 2003, KeySpan issued a request for proposals (“RFP”) to seven wholesale gas marketers to both manage its resource portfolio and to provide city-gate supply to KeySpan’s sales customers (Exh. KED-1, at 1-2). In order to ensure a fair, open, and transparent process, the RFP indicated that KeySpan would hold a pre-bid conference on January 29, 2003, to address questions posed by potential bidders (id.). Prior to the conference, KeySpan requested that any questions regarding the RFP be sent to the Company in writing (id.). The Company held its pre-bid conference and responded to questions from bidders at the conference (id. at 2). On February 6, 2003, KeySpan received four proposals to the RFP, while three recipients declined to bid (id.). Each bid was evaluated based on: (1) the guaranteed management fee offered; (2) key operating assumptions regarding the portfolio; (3) asset-management experience; and (4) creditworthiness (id.). KeySpan selected Entergy-Koch Trading, LP as the winning bidder.

B. EKT Agreement

In D.T.E. 03-40, at 226-227, the Department directed KeySpan to file the EKT Agreement with the Department because the EKT Agreement had been extended beyond a one-year term and, therefore, required Department approval under G.L. c. 164 § 94A (Exh. KED-1, at 4).¹ The EKT Agreement provides that EKT will (1) manage certain

¹ The initial term of the EKT Agreement was April 1, 2003 through March 31, 2004 (Exh. KED-1, at 4). However, on November 15, 2004, the Company submitted a
(continued...)

upstream interstate gas supply, transportation and underground storage assets of the Company, and (2) provide the city-gate gas supply requirements of the Company's sales customers (id. at 4). The Company states that KeySpan will retain the management of its downstream peak shaving resources (id.).

The EKT Agreement provides that EKT will pay a guaranteed fixed fee to the Company in equal monthly installments over the term of the Agreement (id.). The EKT Agreement also allows for profit sharing in two instances: (1) when EKT's capacity mitigation revenues exceed the guaranteed management fee, KeySpan shares a portion of the additional revenues; and (2) if KeySpan grants EKT access to KeySpan's resources that are not part of the Company's resource portfolio for additional management, any revenues generated by EKT from the management of the additional resources (e.g., resources such as downstream peaking shaving assets) will be shared with KeySpan (id. at 4-5). With regard to commodity costs, KeySpan will pay for gas supplies delivered by EKT according to the pricing hierarchy set forth in section 3.1 of the Agreement (id. at 5).

C. Margin Sharing

Under the terms of the EKT Agreement, KeySpan and EKT will share any net profits generated by the sale of KeySpan's assets that exceed the management fee (Exh. KED-1, at 9). The Company will retain 25 percent of the incremental net profits generated from off-system sales transactions conducted under the EKT Agreement in a manner consistent with

¹ (...continued)
revised agreement between KeySpan and EKT that extended the EKT Agreement's term through March 31, 2005 (Exh. AG 1-6 (supp)).

Interruptible Transportation/Capacity Release, D.P.U. 93-141-A (1995) (Exhs. KED-1, at 9; AG 1-11).

III. POSITIONS OF THE PARTIES

A. Request for Proposals Process

The Company argues that the competitive solicitation process was fair, open, and transparent (Company Brief at 2). KeySpan further argues that the bid submitted by EKT compared favorably to reasonably available market options because under the EKT Agreement, the Company's customers will realize the greatest economic benefits while the Company maintains reliability to meet KeySpan's firm sendout requirements (id.).

According to KeySpan, all of the non-selected bidders lacked experience on the gas management information systems used by KeySpan (Exh. KED-1, at 3). The Company states that two of the three non-selected bidders would have required a payment from KeySpan in exchange for the requested services (id.). The Company reports that the third non-selected bidder would have provided a guaranteed management fee² to KeySpan only in exchange for the permanent release of 25,000 MMBtu/day of Algonquin or Tennessee city gate capacity (id.). Further, two of the three non-selected bidders had credit ratings from Standard and Poors that were lower than EKT's credit rating (id.). Finally, KeySpan reports that one non-selected bidder had minimal experience on the Algonquin and Tennessee pipeline systems and another bidder was unwilling to provide invoice reconciliation (id.). Therefore, KeySpan

² The guaranteed fee was less than what EKT offered (Exh. KED-1, at 2).

argues that EKT's bid was superior to the non-selected bids (id. at 3). The Attorney General did not comment on the Company's RFP process.

B. EKT Agreement

1. Attorney General

The Attorney General argues that KeySpan has failed to monitor the transactions conducted under the Agreement (Attorney General Brief at 3). Specifically, the Attorney General asserts that the Company has refused to receive written monthly transaction reports and other correspondence from EKT describing ongoing transactions under the proposed optimization agreement (id., citing Tr. at 32-35, 44-45). Therefore, the Attorney General contends that the Company remains unaware and uninformed of the activities EKT undertakes with the Company's asset (id.).

The Attorney General argues that Massachusetts local distribution companies ("LDCs") have increasingly entered into complex gas portfolio optimization and asset management arrangements including an intricate range of trading activities, which makes a thorough review and monitoring of such activities necessary (id. at 1). Accordingly, the Attorney General urges the Department to modify our standard of review for gas supply contracts and portfolio optimization agreements to include making a finding of prudence (in addition to the "public interest" standard already required) (id.).³ The Attorney General contends that the public

³ According to the Attorney General, a prudence standard of review should require LDCs and their optimization partners to keep detailed and timely documentation of all transactions under gas portfolio optimization and asset management agreements (Attorney General Brief at 2).

interest standard traditionally used by the Department to evaluate gas supply contracts and portfolio optimization agreements does not address an LDC's ongoing activities under an approved contract, which creates the possibility that traders may not act in the best interests of Massachusetts customers (id. at 1-2). Thus, the Attorney General maintains that adding a prudence component to our standard of review will ensure that ratepayers' interests are fully protected, and that LDCs do not pass along costs of portfolio activities to customers unless the company has been prudent in its oversight of the portfolio management (id. at 2).⁴ Finally, the Attorney General argues that the Department should require LDCs to conduct independent external audits of all transactions under such agreements to ensure that the interests of Massachusetts ratepayers are protected (id. at 2).

2. KeySpan

KeySpan argues that the portfolio management agreement with EKT is consistent with the Company's portfolio objectives and compares favorably to market offerings at the time of the execution of the Agreement (Company Brief at 8-9, citing Exhs. DTE 1-2; DTE 1-9; KeySpan Energy Delivery New England, D.T.E. 03-66 (2003); KeySpan Energy Delivery New England, D.T.E. 01-105 (2003); D.T.E. 99-76, at 20-21). According to the Company, because the EKT Agreement only transfers the management of KeySpan's resource portfolio to

⁴ The Attorney General states that, in base rate proceedings, costs must be prudently incurred to be recovered from customers (Attorney General Brief at 2, citing Town of Hingham v. Department of Telecommunications & Energy, 433 Mass. 198, 202 (2001). The Attorney General further states that a company's responsibilities to take all prudent actions to ensure reasonable costs are "nondelegable statutory obligations." (Attorney General Brief at 2, n.2, citing Commonwealth Electric Company v. Department of Public Utilities, 397 Mass. 361, 366, n.2 (1986)).

EKT without delegating any rights to alter, extend, or terminate existing contractual commitments, the flexibility, diversity, and reliability of the Company's portfolio is preserved (Company Brief at 8-9, citing Exhs. AG 1-19; DTE 1-11(b)). Moreover, the Company contends that its customers will not pay any more for their gas supplies under the EKT Agreement than they would have absent the EKT Agreement (Company Brief at 10, citing Exh. KED-1, at 5; Tr. at 94).⁵ The Company explains that since KeySpan is responsible for all demand charges associated with its pipeline and underground storage resources and that commodity charges for city-gate sales service are tied to market indices, commodity prices paid to EKT are at prices equal to or less than the rates KeySpan's customers would otherwise pay had the Company continued to administer commodity purchases (Exh. KED-1, at 5).

According to KeySpan, the evidence contradicts the Attorney General's assertion that the Company has failed to monitor EKT's performance under the EKT Agreement (Company Reply Brief at 3, citing Exhs. KED-2, at 22; AG 1-10 (supp.); RR-AG-4 (supp.); Tr. at 30). KeySpan claims that the Company closely monitors EKT's activities and that the Company is in daily contact with EKT regarding the implementation of the Agreement including the status of all earnings to date (Company Reply Brief at 3, citing Exh. AG 1-10 (supp.)). KeySpan further asserts that the Agreement provides for the Company to audit the financial records of EKT, and that the Company has retained PricewaterhouseCoopers to conduct an independent review of all transactions under the EKT Agreement (Company Reply Brief at 3,

⁵ KeySpan stated that if the EKT Agreement is terminated and that it is not EKT's fault, the Company may be required to share a portion of any negative "Net Profits" as of the date of the termination (Company Reply Brief at 5, n.5, citing Tr. at 92).

citing RR-AG-4 (supp.); Tr. at 30). KeySpan disagrees with the Attorney General that the Company has failed to receive written monthly reports from EKT, arguing that the Company and EKT mutually agreed that monthly reports would not be meaningful because many of the strategies employed by EKT are forward-looking in nature and would only reflect a projection, not actual dollars earned by EKT (Company Reply Brief at 3, n.3, citing Exh. AG 1-10 (supp.), Tr. at 35).

C. Margin Sharing

1. Attorney General

The Attorney General states that his opposition to margin sharing is more fully explained in his briefs filed in Berkshire Gas Company, D.T.E. 04-47 (Attorney General Brief at 2). The Attorney General concedes that a margin sharing arrangement like the one proposed by KeySpan in this proceeding may provide some incentives for the Company to monitor its asset manager (id.). Nevertheless, the Attorney General contends that Department approval of the margin sharing proposal should be conditioned on requiring the Company to keep timely and detailed documentation and to conduct an independent external audit of all transactions under the agreement (id.).

2. KeySpan

The Company argues that its margin sharing proposal is consistent with Department precedent as outlined in 93-141A at 64-65 (Company Reply Brief at 2, n.2). The Company contends that while the Attorney General may have more clearly delineated his opposition to margin sharing in D.T.E. 04-47, the Attorney General has not demonstrated the relevance of

his position in that proceeding to the instant proceeding (id.). The Company claims that since arguments made in the D.T.E. 04-47 case rely on facts not in evidence in this present case, the Department should dismiss any suggestion that those arguments should be applied to this proceeding (id.).

IV. STANDARD OF REVIEW

In evaluating a gas utility's resource options for the acquisition of commodity resources as well as for the acquisition of capacity under G.L. c. 164, § 94A ("Section 94A"), the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). In order to demonstrate that the proposed acquisition of a resource that provides commodity and/or incremental resources is consistent with the public interest, an LDC must show that the acquisition (1) is consistent with the company's portfolio objectives and (2) compares favorably to the range of alternative options reasonably available to the company and its customers, including releasing capacity to customers migrating to transportation, at the time of the acquisition or contract negotiation. Id.

In establishing that a resource is consistent with the company's portfolio objectives, the company may refer to the portfolio objectives established in a recently approved forecast and requirements plan or in a recent review of supply contracts under Section 94A, or may describe its objectives in the filing accompanying the resource proposal. Id. In comparing the proposed resource acquisition to current market offerings, the Department examines relevant price and non-price attributes of each contract to ensure a contribution to the strength of the

overall supply portfolio. Id. at 28. As part of the review of price and non-price attributes, the Department considers whether the pricing terms are competitive with those of the broad range of capacity, storage, and commodity options that were available to the LDC at the time of the acquisition, as well as those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives, including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29. In making these determinations, the Department considers whether the LDC used a competitive solicitation process that was fair, open and transparent. Berkshire Gas Company, D.T.E. 02-56, at 9; Bay State Gas Company, D.T.E. 02-52, at 8 (2002); KeySpan Energy Delivery New England, D.T.E. 02-54, at 9 (2002); Berkshire Gas Company, D.T.E. 02-19, at 11 (2002).

V. ANALYSIS AND FINDINGS

A. Request for Proposals Process

An RFP is acceptable if the process was "fair, open, and transparent." Natural Gas Unbundling D.T.E. 98-32-B at 54-55. The evidence demonstrates that (1) the evaluation process had been clearly stated to each potential bidder, (2) the evaluation criteria were provided, and (3) the pre-bid conference allowed bidders to receive clarification and better understand the Company's objectives (Exh. DTE 1-11). In addition, the bids were evaluated and the winning bidder was selected based on the criteria set forth in the RFP (Exh. DTE 1-3). Further, no objection to the RFP process was raised by bidders (Exh. DTE 1-4). Accordingly,

the Department finds that the RFP process conducted by KeySpan was fair, open, and transparent, and, therefore, acceptable.

B. The EKT Agreement

The EKT Agreement is consistent with KeySpan's most recently approved forecast and supply plan filing approved in D.T.E. 01-105 because it replaces an existing supply source and is not an incremental supply resource. In addition, the Company's proposal is consistent with D.T.E. 99-76, the Company's most recent asset management agreement approved by the Department. In D.T.E. 99-76, at 20-21, the Department found that a portfolio management agreement that merely transferred managerial responsibility of gas supply contracts previously approved by the Department as consistent with the Company's portfolio objectives. Under the proposed EKT Agreement, EKT will manage upstream interstate gas supply, transportation and underground storage contracts previously approved in D.T.E. 01-105 and D.T.E. 03-66 (Exhs. KED-1, at 4; Exh. DTE 1-11). The portfolio of contracts available for management by EKT is the same portfolio of contracts approved in D.T.E. 01-105 and subsequently restructured and approved again in D.T.E. 03-66 (Exh. DTE 1-11).

Further, our review of the Company's Agreement indicates that it compares favorably to current market offerings considering price and non-price factors. EKT's proposal is superior to those offers by the competing respondents in that it offers the largest guaranteed management fee and also allows for additional revenues in the form of profit-sharing (Exh. KED-1, at 4-5). The Department finds that the EKT Agreement represents the highest possible value for customers based on today's portfolio and current market conditions.

Therefore, we find that the Company's proposed asset management agreement with EKT is consistent with the public interest.

In addition, under the EKT Agreement, the Company's customers will not pay more for their gas supplies than they would have absent the EKT Agreement (Exh. KED-1, at 5; Tr. at 94). Given the benefits to customers in the form of the management fee paid to the Company as well as any additional revenues derived from profit-sharing, the Department finds that customers are likely to experience an overall net benefit.

The evidence in this proceeding contradicts the Attorney General's assertion that KeySpan has failed to monitor EKT's performance under the Agreement (Exhs. KED-2, at 22; Exh. AG 1-10 (supp.); RR-AG-4 (supp.); Tr. at 30). The evidence demonstrates that the Company is in daily contact with EKT regarding the operations of the Agreement (Exh. AG 1-10 (supp.)). Further, the Company has retained PricewaterhouseCoopers to conduct an independent review of the transactions under the Agreement (RR-AG-4 (supp.); Tr. at 30). Therefore, we reject the Attorney General's argument that the Company has not monitored EKT's performance under this Agreement.

Although the Attorney General's suggests that the Department amend our standard of review for resource contracts and portfolio optimization agreements to incorporate a finding of prudence, the Attorney General has not provided evidence to support his recommendation (see Attorney General Brief at 2). Therefore, his assertion that a possibility exists where traders may not act in the best interests of Massachusetts customers is mere speculation. We note that since the issuance of D.T.E 99-76, at 21, KeySpan's customers have enjoyed

measurable benefits from the Company's agreements with portfolio managers. The Department also notes that a prudence review prior to the execution of a management agreement is premature and will not address the Attorney General's concerns. A review of whether traders and portfolio managers have acted in the best interest of Massachusetts costumers would logically occur after the completion of an agreement. Therefore, the Department rejects the Attorney General's proposal to amend the standard of review to include a finding of prudence.

C. Margin Sharing

In D.P.U. 93-141-A at 59, the Department acknowledged that the regulatory policy of requiring all margins derived from capacity-management tools (i.e., interruptible sales, capacity release, interruptible transportation, and off-system sales) to flow to firm customers can result in a disincentive for LDCs to make investments that are in the public interest. As a result, the Department accepts margin-sharing arrangements as a mechanism to improve efficiency and, ultimately, resulting in cost savings to customers. Id., citing Incentive Regulation, D.P.U. 94-158, at 47-52 (1995). With respect to the specific percentage margins to be retained by an LDC, the Department has found that the retention of 25 percent of annual incremental margins earned from interruptible sales, interruptible transportation, off-system sales, and capacity release is reasonable. See, e.g., D.P.U. 93-141-A at 64; D.T.E. 99-76, at 23. The Department has found that LDCs should not be penalized with the loss of capacity mitigation as a result of pursuing a portfolio approach that will produce benefits for customers. D.T.E. 99-76, at 22.

The Company proposes to flow the gas costs and revenues associated with the EKT Agreement through KeySpan's cost of gas adjustment clause filing consistent with historical practices (Exh. KED-1, at 9). KeySpan's margin-sharing proposal is consistent with the criteria set forth in D.P.U. 93-141-A. Specifically, the Company's proposal complies with the Department's directives with regard to the allocation of margins, the applicable threshold level, as well as the percentage of margins to be retained by KeySpan. Failure to approve KeySpan's proposed treatment of margins would eliminate all incentives by the Company to seek arrangements such as the current portfolio optimization structure and penalize KeySpan for pursuing such activities with loss of capacity-mitigation revenues, which the Company could earn absent the EKT Agreement. The Department, therefore, finds KeySpan's margin-sharing arrangement to be consistent with the criteria set forth in D.P.U. 93-141-A, and is, therefore, approved.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is hereby

ORDERED: That the gas resource portfolio management and gas sales agreement with Entergy-Koch Trading LP and Keyspan Energy Delivery New England is hereby

APPROVED; and it is

FURTHER ORDERED: That KeySpan Energy Delivery New England shall follow all other directives in this Order.

By Order of the Department

Paul G. Afonso, Chairman

James Connelly, Commissioner

W. Robert Keating, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.